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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff-Applicant, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	Adv. Pro. No. 08-01789 (SMB) SIPA Liquidation (Substantively Consolidated)
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. J. EZRA MERKIN, GABRIEL CAPITAL, L.P., ARIEL FUND LTD., ASCOT PARTNERS, L.P., ASCOT FUND LTD., GABRIEL CAPITAL CORPORATION, Defendants.	Adv. Pro. No. 09-01182 (SMB)

TRUSTEE'S REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF MOTION *IN LIMINE* NUMBER 1 TO EXCLUDE ALL EVIDENCE AND TESTIMONY ON THE ACTIONS OR INACTIONS OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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Irving H. Picard, as trustee ("Trustee") for the substantively consolidated liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.*, and the chapter 7 estate of Bernard L. Madoff ("Madoff"), respectfully submits this memorandum of law and the Supplemental Declaration of Lan Hoang in Further Support of Trustee's Motions *in Limine* Numbers 1, 3, and 4 ("Hoang Suppl. Decl.") in further support of Motion *in Limine* Number 1 to Exclude all Evidence and Testimony on the Actions or Inactions of the United States Securities and Exchange Commission ("SEC"). For the reasons set forth herein, the Trustee's motion should be granted.

INTRODUCTION

Defendants[1] and the Trustee agree that J. Ezra Merkin's ("Merkin") state of mind, namely whether he was willfully blind to a high probability of fraud at BLMIS, is the central issue in this avoidance action. In order for facts to be relevant to this inquiry, Merkin must have been aware of them while Defendants were invested with BLMIS.[2] This personal knowledge requirement conversely applies to any defenses promulgated by Defendants, particularly the defense that the SEC's inspections and examinations of BLMIS or Madoff gave Merkin assurances. Here, however, Merkin did not and could not have known the details of any SEC inspections and examinations of BLMIS or Madoff during his funds' investments with BLMIS

[1] J. Ezra Merkin ("Merkin"), Gabriel Capital Corporation ("GCC"), Ascot Partners, L.P. ("Ascot Partners"), and Ascot Fund Ltd. ("Ascot Fund") are referred to herein as Defendants.

[2] The affirmative defense of good faith under 11 U.S.C. §§ 548(c) and 550(b) has evolved significantly throughout this SIPA liquidation. Prior to this liquidation, the defense of good faith rested on "inquiry notice," where a transferee must conduct a diligent investigation of red flags or demonstrate that a diligent inquiry would not have uncovered the transferor's insolvency or fraudulent purpose. *In re Bayou Grp., LLC*, No. 09 Civ. 02340(PGG), 2012 WL 386275, at *1 (S.D.N.Y. Feb. 6, 2012) ("*Bayou III*") (citing *In re Bayou Grp., LLC*, 439 B.R. 284, 311, 315–17, 328 (S.D.N.Y. 2010) ("*Bayou II*")). "An objective, reasonable investor standard applies to both the inquiry notice and the diligent investigation components of the good faith test." *Bayou II*, 439 B.R. at 313 (citing *Jobin v. McKay*, 84 F.3d 1330, 1336 (10th Cir. 1996)). This lack of good faith has been modified in this liquidation, now requiring Defendants to prove that they were no willfully blind to facts suggesting a high probability of fraud. *Picard v. Katz*, 462 B.R. 447, 455 (S.D.N.Y. 2011) (quoting *United States v. Rodriguez*, 983 F.2d 455, 458 (2d Cir. 1993)); Order, *Picard v. Katz*, No. 11-cv-03605-JSR (S.D.N.Y. Mar. 14, 2012), ECF No. 177.

because (1) the details of those examinations were not contemporaneously disclosed to the public, consistent with SEC procedure; and (2) the only report issued by the SEC concerning BLMIS and Madoff—"Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme"[3]—was prepared and publicly disclosed after the fraud had already been discovered on December 11, 2008. Therefore, it is and could not be possible for Merkin to have been aware of the details of the SEC's inspections and examinations during the pertinent time period, making them irrelevant to the issue of Defendants' willful blindness. Accordingly, such evidence should be excluded in this case.

ARGUMENT

I. DEFENDANTS LACK THE REQUISITE PERSONAL, PARTICULARIZED, CONTEMPORANEOUS KNOWLEDGE TO INTRODUCE TESTIMONY RELATING TO THE SEC'S INSPECTIONS AND EXAMINATIONS OF BLMIS OR MADOFF

Defendants concede the very argument advanced by the Trustee to preclude evidence of the SEC inspections and examinations of BLMIS or Madoff and the OIG Report—that in order for this evidence to be introduced, Merkin must have "personal knowledge of the facts on which he testifies."[4] Yet, the Defendants cannot point to any facts in the record that demonstrate Merkin knew the facts and circumstances of particular SEC inspections and examinations of BLMIS or Madoff, detailed for the first time in the OIG Report issued post-fraud, while his funds were invested with BLMIS. Merkin admittedly never had conversations with the SEC about BLMIS and/or Madoff, never had any knowledge of the evidence the SEC obtained during

[3] U.S. Sec. and Exch. Comm'n Office of Investigations, Report No. OIG-509, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme*, Public Version ("OIG Report") (Aug. 31, 2009), *available at* https://www.sec.gov/files/oig-509.pdf.

[4] Notably, Defendants filed a separate motion *in limine* arguing that any testimony of a witness who suspected that Madoff was engaged in fraud is irrelevant "unless that belief was somehow communicated to Merkin" and where there is "no evidence that these supposed beliefs were communicated to Merkin or that he otherwise knew of them," they should be excluded. Defendants' Memorandum of Law in Support of Their Motion *In Limine* to Exclude Others' Purported Suspicions About Madoff Not Expressed to Defendants at 1, ECF No. 344.

those inspections and examinations, and otherwise never had knowledge of the specific findings of the SEC.[5] Lacking such foundation, Merkin should not be permitted to offer testimony of any details of the SEC's inspections and examinations.

The lack of such personal knowledge and foundation is remarkable with respect to the SEC investigation of Avellino & Bienes, an accounting firm that raised money from investors in order to pool those funds for investment with BLMIS. Defendants have repeatedly asserted that the SEC cleared BLMIS during that investigation. Merkin admits that his knowledge of that investigation comes from two sources, a single newspaper article in the Wall Street Journal and an alleged conversation he had with Madoff. But, the article never represents that the SEC cleared BLMIS, and Merkin cannot remember the details of the alleged conversation with Madoff.[6] If Merkin would like to testify that he read the Wall Street Journal article or that he participated in an alleged conversation with Madoff, he can do so, but he cannot use it as a foundation to testify about something the article does not say or details of an alleged conversation that he admittedly does not recall.[7]

In regard to the OIG Report, which was published after the fraud was discovered on December 11, 2008, Defendants argue that the Trustee cannot know what Merkin knew about the report because Merkin was not questioned about it at his deposition. This argument is counter-intuitive and inherently contradictory. The Trustee did not question Merkin about the OIG Report for the same reason he brought this motion— it is not probative of Merkin's state of mind

[5] Declaration of Lan Hoang in Support of the Trustee's Motions *In Limine* Numbers 1 through 4 ("Hoang Decl.") Ex. 2 (Deposition of J. Ezra Merkin dated Feb. 24, 2015 ("Merkin Feb. 24 Dep.")) at 187:23–189:24.

[6] Hoang Decl., Ex. 3 (Deposition of J. Ezra Merkin dated Feb. 25, 2015 ("Merkin Feb. 25 Dep.")) at 576:25–577:4 ("Q. Other than those articles, did you have any other source of information regarding Avellino & Bienes? A. Other than a discussion with Mr. Madoff about them, no."); Hoang Suppl. Decl., Ex. 22 (Randall Smith, *Wall Street Mystery Features a Big Board Rival*, WALL STREET J., Dec. 16, 1992 at GCC-P 0393125-126, part of "Merkin's Madoff File," Ex. 363 to the Deposition of J. Ezra Merkin February 24-25, 2015, GCC-P 0393096–3607 (full exhibit available upon request)).

[7] The Trustee reserves the right to raise hearsay and all applicable objections to this testimony at trial.

while the Defendants were invested with BLMIS. The OIG Report was published after the fraud was discovered, making it impossible for Merkin to have had personal knowledge of the facts contained therein.

Absent the proper foundation for Merkin's testimony on the SEC's inspections and examinations, Defendants attempt to have the Court take judicial notice of the OIG Report. While the Trustee agrees that the Court could take judicial notice of public records, the Court should decline this request here because the OIG Report post-dates discovery of the fraud and is not probative of the central issue in this case—whether Merkin was willfully blind to a high probability of fraud at BLMIS. A report, which examines the SEC's actions or inactions concerning BLMIS and Madoff, says nothing about what Merkin knew and has no relevance in this case.

II. EVIDENCE AND TESTIMONY ON THE SEC'S ACTIONS OR INACTIONS CONCERNING BLMIS AND MADOFF ARE INADMISSIBLE HEARSAY AND SHOULD BE EXCLUDED

Merkin's testimony concerning what Madoff told him about what the SEC said is hearsay. Defendants argue that those statements are not hearsay because Merkin, in recounting what Madoff told him the SEC said, is doing so to demonstrate the impact it had on his state of mind. Defendants rely on *United States. v. Detrich*, 865 F.2d 17 (2d Cir. 1988), where the court held that the oral statement made by the declarant, "I am getting married in August," and written statements on the same subject made to the police had been improperly excluded. *Id.* at 19–20. Those statements, made at the time of an arrest, were admitted to show that the declarant could have made the same statement to someone else, which was relevant to the issues in that case. *Id.* at 20–21. Notably, Defendants ignore the affirmance of the exclusion of other hearsay evidence offered to prove the declarant's state of mind in *Detrich*, the very testimony that Merkin seeks to offer here. Regarding that evidence, the *Detrich* court found that the declarant's "recital of that

conversation is hearsay—offered to prove the truth of the matter asserted therein—the conversation's content, that is, that [the declarant] *said* these statements were made." *Id*. at 20.

Here, Merkin offers the hearsay statements of what Madoff told him the SEC said for the very same purpose—to prove that the SEC had "cleared" BLMIS and Madoff. Merkin is attempting to recount a conversation to show that it happened, that is, that Madoff told Merkin the SEC cleared BLMIS. This is the very definition of hearsay and should be excluded at trial. *See* Fed. R. Evid. 802; *see, e.g.*, *Bernstein v. Vill. of Wesley Hills*, 95 F. Supp. 3d 547, 559–60 (S.D.N.Y. 2015) (striking part of a declaration referencing a third party who stated that he heard another individual say something, because it was offered for the truth that the statements were made); *Chamilia, LLC v. Pandora Jewelry, LLC*, No. 04-CV-6017 (KMK), 2007 WL 2781246, at *17 n.14 (S.D.N.Y. Sept. 24, 2007) (finding that a witness could not present evidence about why a customer did not make a purchase because "[s]uch evidence is hearsay and inadmissible").

III. EVIDENCE AND TESTIMONY ON THE SEC'S ACTIONS OR INACTIONS CONCERNING BLMIS OR MADOFF SHOULD BE EXCLUDED AS IRRELEVANT AND LACKING IN PROBATIVE VALUE

Defendants argue that the SEC inspections and examinations of BLMIS or Madoff, the specifics of which Merkin had no personal knowledge, are relevant because the SEC had "readily accessible information that could have confirmed BLMIS' operations and trading records." This argument is neither here nor there where the information known to the SEC is not relevant to the inquiry of what was known to Merkin. Restated, what the SEC knew is irrelevant and lacks probative value to the central issues here—whether Merkin was willfully blind to a high probability of fraud at BLMIS. *See* Fed. R. Evid. 401.

Defendants' arguments as to the admissibility of the OIG Report are similarly unpersuasive. Defendants argue that the OIG Report is relevant because it states that "Madoff and BLMIS were investigated several times by the SEC and cleared every time," which shows

that "Madoff's scheme was complex and well hidden." Aside from being misleading,[8] this argument is faulty. Defendants do not address the fact that Merkin had no way of knowing the findings set forth in the post-fraud OIG Report during his investment with BLMIS. Lacking relevance or probative value, the OIG Report should be excluded at trial. *See* Fed. R. Evid. 402.

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that the Court enter an order granting his Motion *in Limine* Number 1 to Exclude all Evidence and Testimony on the Actions or Inactions of the United States Securities and Exchange Commission.

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[8] In fact, the OIG Report disputes the Defendants' account of what happened, stating "The OIG investigation did find, however, that the SEC received more than ample information in the form of detailed and substantive complaints over the years to warrant a thorough and comprehensive examination and/or investigation of Bernard Madoff and BLMIS for operating a Ponzi scheme, and that despite three examinations and two investigations being conducted, a thorough and competent investigation or examination was never performed." OIG Report at 20–21.